United States Court of Appeals

for the Second Circuit

APPELLEE'S REPLY BRIEF

ORIGINAL

77-7212
77-7223

To be argued by
MARTIN I. SHELTON

United States Court of Appeals
For the Second Circuit

UNITED STATES COURT OF APPEALS
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SECOND CIRCUIT

Docket No. 77-7212
Docket No. 77-7223

LEONARD DESSER, MELVIN DESSER and JACOB LANDESMAN,

Plaintiffs-Appellees-Appellants,

against

ROY A. ASHTON,

Defendant-Appellant-Appellee,

and

JAMES YOUNGBLOOD and TRANS-INDUSTRIES, INC.,

Defendants-Appellees.

DEFENDANT-APPELLANT-APPELLEE ASHTON'S REPLY BRIEF

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TABLE OF CONTENTS

	Page
Table of Authorities.....	i
Preliminary Statement.....	1
Reply to Plaintiffs' Version of the Facts..	3
1. Youngblood Prohibited Plaintiffs from Disclosing Information about Transign.....	4
2. Why the Dessers Could Not Tell Youngblood About the June 20, 1966 Agreement.....	5
3. Ashton's Negotiations With Transign Had Plaintiffs' Approval.....	6
4. Ashton Did Not Profit From The Trans-Industries Deal.....	6
Argument	
POINT I	
THE COURT ERRED IN EXERCISING PENDENT JURISDICTION OVER THE STATE LAW CLAIMS...	8
(a) The Court Should Have Dismissed The Pendent Claims Together With The Federal Claims.....	8
(b) The Complaint Failed To State A Cause Of Action.....	12
POINT II	
THE COURT ERRED IN HOLDING THAT THE STATUTE OF FRAUDS WAS SATISFIED.....	16
POINT III	
THE COURT ERRED IN HOLDING THAT THE JUNE 20, 1966 AGREEMENT WAS VALID UNDER NEW YORK GENERAL BUSINESS LAW §340.	21
Conclusion.....	23

Table of Authorities

Cases	Pages
Bradford v. New York Times, 501 F. 2d 51 (2d Cir. 1974)	2
Flammia v. Mite Corporation, 401 F. Supp. 1121 (E.D.N.Y. 1975), 73 Civ. 1571 (E.D.N.Y. July 14, 1976), aff'd 76-7408 (2d Cir. 1976)	1, 17, 18
Gem Corrugated Box Corporation v. National Kraft Container Corporation, 427 F. 2d 499 (2d Cir. 1970)	2, 9
Kavit v. A.L. Stamm & Co., 491 F. 2d 1176 (2d Cir. 1974)	8, 10, 11
Morris Cohon & Company v. Russell, 23 N.Y. 2d 569 (1959)	17, 18
Parrent v. Mid-West Rug Mills, Inc., 455 F. 2d 123 (7th Cir. 1972)	9
Roberts Min. & Mill. Co. v. Schrader, 95 F. 2d 522 (9th Cir. 1938)	9
Ryan v. J. Walter Thompson Company, 453 F. 2d 444 (2d Cir. 1971)	9
United Mine Workers v. Gibbs, 383 U.S. 715 (1966)	8
Waltzer v. Billera, C.C.H. Federal Sec. L. Rep., 1973 Transfer Binder ¶94,011 (S.D.N.Y. 1973)	10

Other	
N.Y. General Business Law §340	21
N.Y. General Obligations Law §5-701	16
1974 Leg. Doc. No. 65(F), McKinney's Session Laws of New York at 1796 (1964)	16
Securities Exchange Act of 1934, 15 U.S.C. §78aa	11

DEFENDANT-APPELLANT-
APPELLEE ASHTON'S
REPLY BRIEF

Preliminary Statement

Defendant Ashton submits this brief in reply to the arguments contained in the Reply Brief of Plaintiffs-Appellees-Appellants and in support of his appeal from the judgment entered against him and in favor of plaintiffs.

In the "Introductory Statement" to their reply brief, plaintiffs contend that defendants are urging this Court to adopt positions which are allegedly contrary to recent decisions of this Court. In fact, however, the decisions which plaintiffs refer to are simply not applicable to the present case.

In Flammia v. Mite Corporation, 401 F.Supp. 1121, 1133 (E.D.N.Y. 1975), 73 Civ. 1571 (E.D.N.Y. July 14, 1976), aff'd, 76-7408 (2d Cir. 1976), the writings clearly show that the plaintiff had been authorized to act as a finder for the defendant.

In Bradford v. New York Times, 501 F.2d 51 (2d Cir. 1974), the Court considered the question of whether a restrictive covenant not to compete with a former employer was reasonable in scope, but there was no question raised there as to whether the restriction was necessary to protect a legitimate economic interest. Clearly, the former employer there was still in business, and the restrictive covenant was approrpriate to protect that continuing business. In the present case, once Youngblood decided not to deal with the Dessers, they had no business to protect.

Gem Corrugated Box Corporation v. National Kraft Container Corporation, 427 F.2d 499 (2d Cir. 1970) was not, strictly speaking, a pendent jurisdiction case. There, the state law claim was predicated on diversity, and the Court raised the question of subject matter jurisdiction on its own motion only because, prior to judgment, the original defendant was acquired by a corporation which was domiciled in the same state as the plaintiff corporation.

In this reply brief, defendants will demonstrate that plaintiffs' reliance on these and other cases is misplaced and that the complaint in this action should have been dismissed in its entirety.

Reply To Plaintiffs' Version Of The Facts.

Plaintiffs disagree with defendants' contention that the Court below consistently adopted defendants' version of the facts and rejected plaintiffs'. To support their theory, plaintiffs cite the Court's holdings that the June 20, 1966 Agreement was not induced by fraud, that the Agreement did not lack consideration, and that the Agreement did not violate New York's Donnelly Act. (Plaintiffs' Reply Brief, page 1). Obviously, however, these are not findings of fact but inferences and conclusions of law. The Court's findings of fact, which are

clearly labeled as such in the Court's opinion (A.120) are supported by ample evidence, and, in turn, support defendants' arguments, not plaintiffs.

1. Youngblood Prohibited Plaintiffs From Disclosing Information About Transign.

The Court below explicitly found that Youngblood restricted plaintiffs' use of the information which he gave them about Transign and specifically directed them not to reveal the information or to "shop around" with his company (A 121). It is not surprising that plaintiffs ignore this finding, because their immediate violation of the restriction indelibly tainted their relationship to Youngblood and their relationship to Ashton, and it made it necessary for the Dessers to deceive both sides in order to maintain their precarious position.

The Court's finding that Youngblood had confided information to the Dessers in confidence was not based merely on the demeanor of the witnesses, although that alone would have been sufficient. Instead, it was based on substantial evidence, including the terms of the initial advertisement placed in the Wall Street Journal by the Dessers, which promised strict confidence (A 117); it was based on the Dessers' misuse of their supposed connection

with an Archdiocese of the Catholic Church to lull Youngblood into the belief that they could be trusted (Youngblood, T.M. 779; 806-807); and it was based on the terms of Youngblood's initial response to the Dessers in which Youngblood did not reveal the name or nature of his company, and in which he specifically agreed to discuss his company only with the "qualified representative" of the tax free foundation which had allegedly placed the ad (A 120).

2. Why The Dessers Could Not Tell Youngblood About The June 20, 1966 Agreement.

Because the Dessers could not afford to let Youngblood know that they disregarded his instructions and had "shopped around" with his company, they could not possibly disclose to him the fact that Ashton was not a member of their own organization; and for the same reason, they could not possibly have told Youngblood about the existence of the June 20, 1966 Agreement until after Youngblood had discovered their duplicity and decided that he would have nothing to do with them. The Court's explicit findings on this point are unassailable (A 128; A 160).

3. Ashton's Negotiations With Transign Had Plaintiffs' Approval.

Plaintiffs contend that Ashton commenced negotiations with Transign the very night the Dessers left Detroit (Plaintiffs' Reply Brief, page 3). There is no basis whatsoever for this suggestion. In fact, although Ashton was invited by Youngblood to pursue the acquisition without the Dessers, he did nothing whatsoever to do so until after the Dessers had agreed to accept a finders' fee from British American. As demonstrated in defendants' principal brief (page 21), the documents which plaintiffs themselves introduced into evidence demonstrated the inaccuracy of plaintiffs' argument.

4. Ashton Did Not Profit From The Trans-Industries Deal.

Plaintiffs contend that the Court found that Ashton made a "considerable profit" by participating in the Trans-Industries deal (Plaintiffs' Reply Brief, page 5). Although the Court did say so in its opinion following the trial on liability (A 133), there was no basis for such a finding since no evidence whatsoever was offered in that trial to show the value of what Ashton received. In the trial on damages, however, Ashton testified at length about the result of his investment in Trans-Industries. His testimony, which was completely uncontradicted, demonstrated

that he sold no stock in the Trans-Industries public offering; that his stock was restricted in any event, not freely tradable, and that he had a net loss on his investment in Trans-Industries stock (Ashton trial testimony on December 7, 1976). The Trans-Industries prospectus (Plaintiffs' Exhibit 8) also shows that it was the company, not Ashton or Youngblood, which sold the stock.

Argument

POINT I

THE COURT ERRED IN EXERCISING PENDENT JURISDICTION OVER THE STATE LAW CLAIMS.

(a) The Court Should Have Dismissed The Pendent Claims Together With The Federal Claims.

Plaintiffs argue that it was appropriate for the Court to decide the pendent claims even after it dismissed the federal claims. In so arguing, plaintiffs rely on a number of inapplicable cases and misread this Court's decision in Kavit v. A.L. Stamm & Co., 491 F.2d 1176 (2nd Cir. 1974).

In their reply brief, plaintiffs cite several cases which they contend stand for the proposition that a federal court may entertain pendent jurisdiction over state law claims even after dismissing the federal claims prior to trial (Plaintiffs' Reply Brief, page 9).

The first and most appropriate answer to this argument is the Supreme Court's admonition in United Mine Workers v. Gibbs, 383 U.S. 715, 726 (1966) that:

> "Certainly, if the federal claims are dismissed before trial, even though not insubstantial in a jurisdictional sense, the state claims should be dismissed as well...."

The particular cases which plaintiffs cite do not entitle the Court to disregard the Supreme Court's direction in Gibbs.

As we have already discussed (page 2 , supra), Gen Corrugated Box Corporation v. National Kraft Container Corporation, 427 F.2d 499 (2nd Cir. 1970) was not truly a pendent jurisdiction case. In that case, there was diversity jurisdiction at the time the action was commenced. The Court held, in accordance with well settled authority, that the defendant's subsequent transfer of its interest in the subject matter of the litigation to a corporation which had the same domicile as the plaintiff did not oust the Court of jurisdiction. See, e.g. Roberts Min. & Mill. Co. v. Schrader, 95 F.2d 522 (9th Cir. 1938).

In Ryan v. J. Walter Thompson Company, 453 F.2d 444 (2nd Cir. 1971) and in Parrent v. Mid-West Rug Mills, Inc., 455 F.2d 123 (7th Cir. 1972), the Court exercised pendent jurisdiction over the state law claims only to dismiss them on the merits.

In Waltzer v. Billera, C.C.H. Federal Sec. L. Rep., 1973 Transfer Binder ¶94,011 (S.D.N.Y. 1973), the Court adjudicated federal and state claims on cross-motions for summary judgment. Keeping the state claims did not involve continuing a trial for 5 additional days as it did here.

Plaintiffs contend that the principles set down by Judge Friendly in Kavit, supra, should be applied only where the exercise of pendent jurisdiction deprives the defendant of a more substantial right than the right to have a state law claim determined by a state court. Thus, plaintiffs argue, the dictum in Kavit was prompted by the fact that the pendent claims there would have been subject to arbitration had they been brought in state court. Judge Friendly's own words refute this restrictive interpretation of his opinion. He stated (491 F.2d at 1179):

> "Quite apart from the arbitration problem, the flimsy nature of federal claims may call for dismissal of pendent state claims."

In the present case, the District Court's decision to retain the state law claims after dismissing the federal claims affected more than defendants' right to have state law claims tried by a state court. In particular, defendants Youngblood and Trans-Industries

were served with process in this action in Bloomfield Hills, Michigan (A 15, A 16). The service was effected under the liberal provisions of the Securities Exchange Act of 1934, 15 U.S. Code §78aa. Since there was no allegation that either Youngblood or Trans-Industries had ever had any contact with New York in connection with the transactions which give rise to this lawsuit, they would not have been subject to in personam jurisdiction in a New York State Court.

Plaintiffs also point to Judge Friendly's reliance, in Kavit, on the defendants' failure to appeal from the District Court's decision refusing to dismiss or stay the action but, in Kavit, that decision was appealable as of right because it involved a refusal to stay the action pending arbitration. 491 F.2d at 1181. In the present case, the District Court's decisions which refused to dismiss the complaint were not appealable as of right. Moreover, in Kavit, the defendants had not requested a separate trial of the state law claims. Id. at 1182-1183. In the present case, defendants did so (A 96) and, despite plaintiffs' repeated arguments that the jurisdictional questions could not be separated out for trial, it is clear that there was one central

issue on which the jurisdiction of the Court depended: namely, whether there had been a contract to purchase or sell securities. According to plaintiffs' own contentions, the contract was made at a single meeting, and the evidence of what happened at that meeting could have been taken in less than one day.

Plaintiffs argue that their self-imposed hardship and the District Court's self-perpetuating error in proceeding to trial on the pendent claims justify the District Court's exercise of pendent jurisdiction. If such arguments are adopted, then any synthetic federal claim can become the basis for imposing on a federal court what should have been a state law case , and no amount of diligent objection by defendants will preserve their rights.

(b) The Complaint Failed To State A Cause Of Action.

All of plaintiffs' arguments on the jurisdictional issue are predicated on the basic proposition that the complaint which they filed after two unsuccessful attempts to plead a federal claim succeeded in doing so. An analysis of the so-called federal claims in the complaint will demonstrate that it did not. Plaintiffs' complaint alleges that Ashton fraudulently represented to plaintiffs

that they would "receive" 35% of the stock of a non-existent company which was to be formed by the plaintiffs and British American Insurance Company - which is not a party to the action - for the purpose of acquiring Transign Corporation. Plaintiffs then allege that they were deprived of the opportunity to buy 35% of the stock of Trans-Industries (which they allege was formed by Ashton, not by British American)(A 54-56). There is no indication whatsoever in the complaint as to who was selling which stock to whom or for how much. There is no mention whatsoever of any written agreement to purchase or sell any stock nor are any of the other essential terms of an agreement to buy or sell stock described in the complaint.

On the basis of the allegations of the complaint and plaintiffs' pre-trial admissions, defendants moved for summary judgment to dismiss the complaint (A 72). Plaintiffs themselves had admitted that they knew that their preliminary discussions with Ashton were subject to the approval of his company; that, after June 20, 1966 (the date on which the "agreement" was allegedly made) plaintiffs prepared a "proposal" for Ashton, who advised the Dessers that his colleague, Mr. Courtney, would have to see it; that, when Mr. Courtney did see it, "he was unhappy with it" and "he didn't think the people

would go along with it." When asked whether Courtney told the Dessers "what he thought his people might be interested in," Leonard Desser replied:

> "I can say positively not, because there was no counteroffer type of thing." (Emphasis added)*

Most importantly, plaintiffs withheld until the very eve of trial several crucial documents which served to demonstrate not only that they intended their discussions to be only a prelude to a formal, written agreement, but also that the parties to the discussions had not even agreed on who would be parties to the alleged agreement. Thus, while the complaint alleges, and plaintiffs testified at trial, that the Dessers and British American were to be the parties, the draft agreement which plaintiffs turned over on the eve of trial (A 105) provides that only British American and Leonard Desser were to be parties to the "agreement".

By trial, of course, the preliminary discussions, proposals and unaccepted offers were miraculously transformed by plaintiffs' artful testimony into a detailed, definitive, binding agreement. Needless to say, the trial

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* These admissions, with their sources, are collected in the affidavit of Martin I. Shelton, sworn to on August 22, 1975 and submitted in support of the motion for summary judgment (A 74 at 83-84).

court did not credit plaintiffs' testimony on this point and found that there was no agreement to purchase or sell securities (A 127), as defendants had contended all along.

That fact did not need to be established by testimony at trial. The confused, ever-changing and ambiguous nature of plaintiffs' allegations, together with their pre-trial admissions, established as a matter of law that there was no contract, and the District Court erred in investing judicial time in a trial of plaintiffs' fabricated federal claims.

POINT II

THE COURT ERRED IN HOLDING THAT THE STATUTE OF FRAUDS WAS SATISFIED.

Plaintiffs seem to contend in their reply brief (pages 21 et seq.) that the New York Statute of Frauds (Gen. Obligations Law §5-701) need not be satisfied in a case based on quantum meruit.

The cases which plaintiffs cite on this point were decided prior to the 1964 amendment of the Statute of Frauds which specifically prohibited recovery on "contracts implied in fact or in law to pay reasonable compensation." Gen. Obligations Law §5-701(10). Those earlier cases must be disregarded.

Since the amendment of the Statute of Frauds in 1964, there can be no question under New York State law that the statute cannot be avoided by claims in quantum meruit. 1964 Leg. Doc. No. 65(F), McKinney's Session Laws of New York at 1796 (1964). Where the statute is satisfied by a written memorandum sufficient to demonstrate that the plaintiff has, in fact, been employed by the defendant to perform services for compensation, the amount of compensation

may be fixed in the Court on the basis of its reasonable value. That is the only significance of the holding in Morris Cohon & Company v. Russell, 23 N.Y. 2d 569 (1959).

Flammia v. Mite Corporation, 401 F.Supp. 1121 (E.D.N.Y. 1975); 73 Civ. 1571 (E.D.N.Y. July 14, 1976) (decision after trial); aff'd, 76-7408 (2d Cir. 1976), which plaintiffs rely on heavily, is distinguishable. In that case, the written documents clearly established that the defendant had authorized the plaintiff to act on the defendant's behalf in pursuing negotiations for an acquisition. As the Court there stated (401 F. Supp at 1133):

> "The communications...sufficiently identify the seller; identify and establish plaintiff's role in the negotiations; establish the subject matter of the transaction; and most important, acknowledge performance by and obligation to the plaintiff as a consequence of his assistance in arranging the sale...."
> (Emphasis added).

The Court below concluded in this case that the June 20, 1966 Agreement together with the August 31, 1966 Agreement (to which Ashton was not a party) constitute a sufficient memorandum to satisfy the statute of frauds. The June 20, 1966 Agreement, however, does not, by its terms or by any reasonable inference from its terms, suggest that plaintiffs are performing any service on

behalf of anyone or that they are being employed by anyone. Thus, that document does not evidence the essential "fact of employment" which was demonstrated in the Cohon and Flammia cases by the documents themselves.

Contrary to suggesting any employment relationship between plaintiffs and defendant Ashton or between plaintiffs and British American, the document quite clearly shows that it was plaintiffs who were expecting British American and Ashton to perform a service for them. The Agreement states (A 102):

> "You [plaintiffs] have indicated... that you are in possession of information in regard to a particular manufacturing company (The Company) and that you wish to have the undersigned [Ashton] finance the acquisition of the Company on terms and conditions mutually agreeable to you and the undersigned."

This interpretation of the agreement is entirely consistent with the position plaintiffs took throughout the negotiations which they had with British American. They repeatedly stated that they were not finders but principals who were entitled to participate in a purchase of Transign as equity owners.

It was only when Youngblood decided that he would not sell Transign to plaintiffs, or to any partnership which included plaintiffs, that they suggested that they were entitled to a finders' fee instead. The belated finders' fee claim was accepted by British American (not by Ashton) in the August 31, 1966 Agreement (A 109). By its very terms, however, that agreement provided that it was to be null and void unless British American should acquire Transign. It is undisputed that British American never did acquire Transign.

Therefore, the Court's reliance on that agreement as evidence of plaintiffs' "employment" by Ashton is entirely and completely misplaced. First, it was not made by Ashton; second, it was not an employment agreement; and finally, it was null and void by its very terms.

Thus, the Statute of Frauds has not been satisfied in this case and the Court was not entitled to give plaintiffs any recovery in the nature of quantum meruit.

Finally, it should be pointed out, contrary to the statement made in plaintiffs reply brief (page 21), that defendants did strenuously object to the amendment of the pleadings after trial to assert a finders' fee claim (See T.M. 852 and Defendants' Post Trial Reply Brief, page 24).

If the June 20, 1966 Agreement is read as defendants believe it should be -- namely, as a negative covenant on Ashton's part -- it is indisputable that the Court applied the wrong measure of damages, a measure which gave plaintiffs more than they would have gotten from Ashton's compliance with the contract.

POINT III

THE COURT ERRED IN HOLDING THAT THE JUNE 20, 1966 AGREEMENT WAS VALID UNDER NEW YORK GENERAL BUSINESS LAW §340.

Plaintiffs argue that the restrictions contained in the June 20, 1966 Agreement are reasonable in scope and cite several cases which relate to the question of reasonableness (Plaintiffs' Reply Brief, pages 29 et seq.) The reasonableness of the restriction is, however, only one of the factors which the Court must consider in deciding whether a restriction is valid.

The significant point which plaintiffs have chosen to ignore in this case is the requirement that a restriction, in order to be sustained, must be both reasonable in scope and necessary to protect a legitimate economic interest. In the caseswhich plaintiffs cite, relating primarily to noncompetition agreements entered into by former employees, the Courtshad no occasion to consider the second question, because a former employer which is still engaged in business has an obvious interest in preventing competition from a former employee.

In the present case, however, as defendants have demonstrated time and time again, and as the Court below

acknowledged (A 131), the Dessers were out of business so far as an acquisition of Transign was concerned. The Court below held that Youngblood was absolutely entitled to refuse to deal with the Dessers (A 149). Therefore, they were no longer in the business of acquiring Transign, seeking a purchaser for Transign or financing for Transign. Under those circumstances, they had no legitimate economic interest to protect and the restriction must fall.

CONCLUSION

The judgment against defendant Ashton should be reversed and the judgment dismissing the first, second and fourth causes of action in the complaint should be affirmed.

Respectfully submitted,

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—o—

STATE OF NEW YORK }
CITY OF NEW YORK } ss.:
COUNTY OF NEW YORK }

HARRY GUZMAN, being duly sworn, deposes and says, that he is over 18 years of age. That on the 1st day of September, 197 7, he served 2 Copies of the attached Reply Brief on the attorney s for the Plaintiffs-Appellees-Appellants herein by depositing the same, ~~properly enclosed in a securely sealed postpaid wrapper in a U.S. Post Office at 90 Church Street, New York City, directed to~~ said attorney s ~~xx~~ Lans Feinberg & Cohen
555 Madison Avenue
New York, New York

that being the place where they maintain offices for the regular transaction of business, and the last address mentioned in the papers last served by them.

Hans Guzman

Sworn to before me this

1st day of September , 1977 .

Monroe D. Rosen

MONROE D. ROSEN
Notary Public, State of New York
No. 24-4616690
Qualified in Kings County
Commission Expires March 30, 1979